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SIPDIS

SENSITIVE

STATE FOR E, P, EUR/SE AND EB
TREASURY FOR U/S TAYLOR AND OASIA - MILLS
NSC FOR QUANRUD AND BRYZA

E.O. 12958: N/A
TAGS: ECON PREL TU
SUBJECT: TURKISH ECONOMY MARCH 26: U.S. AID PROPOSAL SPARKS LIMITED RALLY; IMF REPORTS PROGRESS ON FOURTH REVIEW

Sensitive but unclassified, and not for internet distribution.

¶1. (SBU) Summary: Markets rallied March 26 am with T-bill yields dropping six percentage points, on news of the U.S. war supplemental for Turkey. But market sentiment remains pessimistic about upcoming debt roll-overs, and the GOT's credibility with the markets remains rock bottom. IMF resrep reports overnight progress towards finalizing the LOI, which now could be signed by mid-next week. State Planning Chief told us the GOT is serious about moving forward quickly on reforms to help restore market confidence. End Summary.

Markets Improve, But Foreigners Stay Out for Now

¶2. (SBU) Turkish markets rallied on March 26 am, on further news that the USG's supplemental budget request to Congress includes a $1 billion grant to Turkey, potentially convertible into as much as $8.5 billion in loans.

-- Lira-denominated T-bill yields dropped to 64 percent compounded (yesterday's close was 70 percent.)

-- The lira appreciated nearly 3 percent, trading at TL 1,690,000 to the dollar at mid-day.

-- The Istanbul Stock Exchange 100 index closed up 3.4 percent in light trading.

¶3. (SBU) Foreign investors are staying out of Turkish markets for now, per local brokers and bond traders. Some market analysts (Bender Securities Golkan, Eurosource's Ucer) believe Turkish banks are driving down T-bill yields partly for end of quarter "window dressing" purposes, i.e., making the asset side of their balance sheets (stuffed with T-bills) look temporarily better as of Monday March 31. We agree that in general markets remain unhappy with the GOT, and there is ongoing concern with the GOT's ability to comfortably roll-over debt in advance of large debt redemption dates (April 9, May 21, June 4 and June 18). We note the managers of the top four Turkish banks are in Ankara in talks with MinState Babacan to express their concerns. State Bank Board Chairman Ocak told Econ Counselor March 26 that "Istanbul remains furious with the GOT;" he believes immediate credible steps are needed to repair market sentiment.

¶4. (SBU) Comment: Nevertheless, with yesterday's announcement on the war supplemental, analysts here see the possibility of a good scenario based on two elements: the GOT repairing relations with IMF, finishing the Fourth Review and continuing to implement reforms; the reduced but still existing perception that the USG won't let Turkey's economy meltdown during the Iraq war. End Comment.

Progress on the IMF Fourth Review

¶5. (SBU) IMF resrep briefed us this morning on the results of his March 25 evening meeting with Turkish Treasury U/S Oztrak. Resrep said if the progress continued, he could foresee signing the LOI as early as mid-next week, with a possible Board date as early as mid-April.

-- Timing. Oztrak was pushing for signing the LOI this Friday, and IMF staff seeking a Board date before the $3 billion debt redemption on April 9. Resrep said this was over-optimistic. If progress continued, the IMF could issue a positive statement on the Fourth Review in advance of the April 9 redemption.

-- Macro-Economic Targets. Treasury asked the IMF to delay revising the program's macro framework until the Fifth Review, in order to expedite consideration of the Fourth Review. IMF staff was weighing this request. Current volatilities (market roller coaster, uncertain growth projections, possible need to revise inflation targets) all argued in favor of postponing until the Fifth Review, he noted. But he wouldn't second guess the decision of IMF headquarters.

-- Issues for Signing the LOI. If the IMF agrees to postpone revision of the macro-economic framework, there are still at least two policy issues left to be resolved before the LOI can be signed, per Resrep. First, the GOT must identify the sources for the TL 4 quadrillion in spending delays announced on March 24. Oztrak said the plan is to pass the budget as planned on March 28, and then within five days thereafter to issue a circular to all ministries indicating which expenditures must be delayed. For LOI purposes, however, these additional 2003 spending delays or blocks must be reflected in the central government primary balances annex (there is a bimonthly performance criterion for this balance), and the IMF won't agree to delay this until the Fifth Review. Second, the GOT has not yet canceled the pending investigations into the BRSA over the June 2002 intervention of Pamukbank.

-- Prior Actions for Finishing the Fourth Review. Resrep reported progress also on the four key prior actions. First, the parliament would vote on the 2003 budget on March 28. Second, IMF staff have approved the draft Direct Tax Reform bill, which is slated to be submitted to the parliament's budget and planning commission on March 27 (the prior action is passage through this commission). Third, the GOT is preparing two regulatory measures to address over-staffing in state enterprises (a Cabinet decree to cancel earlier decrees that prevent forcible retirements; a new schedule and strategy for eliminating redundant positions by year-end). Fourth, the TEKEL privatization plan faces one last obstacle: the Competition Board currently wants to break up the tobacco and spirits units into smaller pieces, while the privatization plan is to sell them as entire units to maximize buyer interest and GOT revenue from the sale. The World Bank is advising to proceed with the existing plan, and amend it later if the Competition Board's final ruling requires splitting up the privatization tenders.

State Planning Chief Asserts GOT is Serious
About Reforms

¶6. (SBU) In a March 26 meeting with Econ Counselor, State Planning U/S Ahmet Tiktik said the government understood the need to take significant steps to bolster market confidence, and was beginning to take those steps. Most important, per Tiktik, the government would implement the March 24 announcement on TL 4 quadrillion of spending delays by freezing non-compulsory spending, including public investments and certain transfers. He described this as a temporary, emergency measure to build up Treasury's cash reserves. Tiktik said the government would also try to accelerate structural reforms, including privatization. We noted the precariousness of Turkey's financial situation and the lack of confidence among investors, and stressed the need for bold action -- not just rhetoric -- in the coming days. We also suggested that the government consider steps outside of the IMF program -- such as accelerating telecom liberalization -- to demonstrate to investors that it has a long-term plan to promote growth and competitiveness, in addition to a short-term plan to avoid financial collapse.
PEARSON